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Recent Cases

Hugh G. Wade

Joseph P. Josephson

Don P. Murnane

RECENT CASES

BANKRUPTCY—FRAUDULENT CONVEYANCES—ASSIGNMENT OF ACCOUNTS RECEIVABLE VALIDATED BY CONNECTICUT STATUTE—A bank made loans to a corporation on a revolving basis in exchange for several demand notes. Each note was secured by a schedule of assigned accounts receivable. In accordance with the contract of assignment the bank hired an agent in the corporation to keep the proceeds from the assigned accounts segregated and to deliver them promptly to the bank. The company was required to make notations on all of its records identifying those accounts which were assigned and to segregate any merchandise which was returned by the debtor of such accounts until new accounts were substituted to cover the value of the returns. The bank maintained a four to three collateral to loan ratio at all times. In a proceeding to reorganize the corporation under the Bankruptcy Act these assignments were attacked as fraudulent by the United States, a substantial creditor. *Held:* Although the company had sometimes substituted fresh accounts for those which had been previously assigned and had, in a few instances, not made the notations which the contract required, the assignments were valid. *In the Matter of The New Haven Clock & Watch Company, Debtor,* 253 F. 2d 577 (C.A. 2d, 1958).

Assigned accounts receivable have had a turbulent judicial history. It is the law in the vast majority of American jurisdictions that chattel mortgages on merchandise are void where the mortgagor reserves a right of sale. Cohen and Gerber, *Mortgages of Merchandise,* 39 COL. L. REV. 1338 (1938). However, it came as a surprise to many lawmen when the Supreme Court by analogy announced a similar rule for accounts receivable. *Benedict v. Ratner,* 268 U.S. 353 (1925). This decision may be criticized both for its judicial reasoning [2 GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES (1940) §§ 592-593] and because it encumbered the use of an otherwise extraordinarily attractive security device. However it remains firmly entrenched in our commercial law, having been cited over 140 times. The dogma of *Benedict v. Ratner* is that where a debtor, who has assigned accounts receivable to secure a debt, is allowed to exercise unfettered dominion over the proceeds of those accounts, the assignment is fraudulent *per se* as to all other creditors. It had been thought that the rule regarding chattel mortgages rested upon the "reputed ownership" of the mortgagor who retained possession and that, therefore, the transfer of intangibles such as accounts were not so limited. In the *Ratner* decision Mr. Justice Brandeis held that the rule "rests not upon seeming ownership because of possession retained, but upon a lack of ownership because of dominion reserved." The mortgagee or assignee can not claim a security interest where there has been no transfer of control.

The full import of this decision did not become clear until after the crash of 1929. Then lenders who had theretofore been satisfied by a surety became suddenly cognizant of the need for substantial security. Accounts receiveable were an inviting source. *Benedict v. Ratner* had arisen under the National Bankruptcy Act. However Justice Brandeis made it clear that fraud was to be determined by state law. Ostensibly he was applying what he thought to be the law of New York because of its rule as to chattel mortgages. In subsequent cases the federal courts in

other jurisdictions applied the doctrine of the *Ratner* case whenever the state law was in doubt. This was the usual case. An important amplification of the doctrine is the rule that where the assignor is permitted to assert full control over goods which are returned by a customer whose account has been assigned the entire assignment will be deemed fraudulent. *Lee v. State Bank and Trust Co.*, 38 F. 2d 45 (C.A. 2d, 1930). Despite the courts' decisions, assignment of accounts receivable gained in favor as a security device throughout the 1930s. Lenders learned to live with *Benedict v. Ratner*. The typical transaction took the familiar form of a self-liquidating loan. The borrower promptly delivered all the proceeds of the assigned accounts to the lender until the loan was paid in full. If financing was needed over a long term the loans were made on a revolving basis; new loans and new assignments being made as earlier loans were repaid. Some jurisdictions ruled that the assignor could be permitted to subsitute new accounts so long as the assignee did not abandon control of the collateral or allow it to be diminished even temporarily. *In re Pusey, Maynes, Breish Co.*, 122 F. 2d 606 (C.A. 3d, 1941). This device would have greatly facilitated long term loans, but it was not generally adopted. In the subject case Judge Medina holds that the bank had sufficiently policed the assignments to protect them under the ground rules which have grown up around the *Ratner* doctrine.

It should be noted that we are dealing in this note with non-notification assignments. The assignee takes the assignment, but does not notify the account debtors, nor does he assume the risk of non-payment of the accounts. It is a security transaction. Merchants generally feel that their credit will be impaired if it becomes known that they have assigned their accounts. Therefore, although the assignee can consolidate his position by notifying the account debtors, this is only done when the condition of the assignor is critical. The doctrine of *Benedict v. Ratner* probably is the result of judicial disapproval of the secrecy surrounding the transaction. As the stigma attached to the assignment of accounts has begun to disappear, the practice of "factoring" accounts has increased in recent years. This is a sale. The "factor" pays for the accounts, notifies the debtors, and assumes the risks. There are relatively few legal problems attached to this procedure. Kelly, *Modern Factoring and How it Meets Today's New Financial Requirements*, 42 A.B.A.J. 13 (1956). The uneasy truce between the courts and the financing companies was shattered by the 1938 amendment to Section 60(a) of the Bankruptcy Act. In effect, this made any transfer which could have been defeated by a bona-fide purchaser during the four month period immediately prior to the filing of the bankruptcy petition voidable as a preference. The validity of assignments of accounts receivable became dependent on the law governing a hypothetical case of double assignment. In *Corn Exchange Nat. Bank & Trust Co. v. Klauder* [318 U.S. 434 (1943)] the Supreme Court ruled that assigned accounts were vulnerable in states which follow the English rule that an assignee of a debt who fails to notify the debtor is defeated by a subsequent assignment. A district court held that they were likewise vulnerable in those states which followed the "American rule" that a subsequent assignee is permitted to retain payment received in good faith. *In re Vardaman Shoe Co.*, 55 F.Supp 562 (E.D.Mo., 1943). Only in New York where the prior assignee can recover any payments made to a subsequent assignee and prevails over him in every situation, was the assignment of accounts receivable still a safe security device. Succumbing to the subsequent agitation, 33

states passed statutes designed to protect account receivable financing from the *Klauder* and *Vardaman Shoe* decisions and in 1950 Congress reamended Section 60 making all of these acts apparently obsolete.

There remains, however, the intriguing possibility that the state statutes enacted to counteract the *Klauder* and *Vardaman Shoe* cases may have abrogated the rule of *Benedict v. Ratner* either in whole or in part. There were three general types of statutes. Three states passed "bookmarking" statutes providing for notation of assignment on the books of the borrower-assignor as a means of perfecting the assignment against all third persons. Fifteen states provided for the perfection of assignments by filing notice of intention to assign accounts. Fifteen other states passed statutes which simply asserted the validity of assignment of accounts receivable. These latter were called "validation statutes." Unfortunately there was very little uniformity among the statutes even within the three classes. See Koessler, *New Legislation Affecting Non-Notification Financing of Accounts Receivable,* 44 MICH. L. REV. 563 (1946). The most interesting part of Judge Medina's decision in the subject case is his statement that "Although the Bank's control over its security interest thus adequately fulfilled the policing requirements under the rule of *Benedict v. Ratner,* an alternative ground for rejecting the Government's argument lies in the obvious validity of the assignments under the applicable and controlling Connecticut statutes. . . ." He then cites one of the earliest of the validation statutes mentioned above. CONN. GEN. STATS. 1949, §§ 6719-6720. Courts have rejected the contention that a similar statute applied to the *Benedict v. Ratner* situation in the only other case in point. *Mount v. Norfolk Savings & Loan Corp.,* 192 F. 2d 286 (C.A. 4th, 1951). The language of the statute in that case [VIRGINIA CODE OF 1950, § 11-5] was at least as sweeping as that in the subject case. "Such assignments shall take effect according to their terms and be valid and enforceable . . . against all persons whomsoever and in any event." The only named condition is that the assignment be in writing.

Insofar as the doctrine of *Benedict v. Ratner* was a reaction to the secrecy of assignments it can be argued that it is no longer justified today, when assignments are commonplace. This argument is fortified in those states which passed the bookmarking and notice filing statutes mentioned above. The effect of these statutes on the doctrine seems never to have been decided. Several of them expressly abolish it. e.g. 5 WASH. REV. CODE § 63.16.030 (1951). In other states this is accomplished in a Factors Lien Act. e.g. N.H. Laws (1951) c. 218, § 4. The Uniform Commercial Code also abolishes the rule. § 9-205.

A tabulation of the state legislation in the area of commercial financing is beyond the scope of this note. However it might be noted that the District of Columbia is almost isolated among the jurisdictions by the fact that it has no such legislation and almost no case law. Some broad provisions such as those in the Uniform Commercial Code would seem to be badly needed here.

HUGH G. WADE

CONSTITUTIONAL LAW—CIVIL RIGHTS—VIOLATION OF PENAL ORDINANCE CANNOT SUPPORT ACTION FOR DAMAGES—The plaintiff was a white woman and her husband was a Negro. They entered a restaurant and dance hall owned and operated by the defendant in the District of Columbia. Refreshments were ordered

and served. As the plaintiff and her husband began to dance the defendant instructed one of his employees to inform the couple that 'mixed dancing' was not permitted. The employee ordered plaintiff not to dance with her husband. After an orderly protest by the plaintiff, insulting and abusive remarks were made to her by the defendant's employee in the presence of patrons. The plaintiff brought an action against the proprietor for compensatory and punitive damages, alleging that she suffered humiliation, embarrassment, anguish, and anxiety, as a consequence of these remarks. Basic to the plaintiff's claim was her contention that the defendant's conduct violated two acts of the local District legislature adopted in 1872 and 1873. (Title 47, Sec. 2907, 2910, 2911, Sup. VI to D. C. Code, 1951 Ed.) Also she alleged a violation of an act adopted in 1869 and enlarged and amended in 1870 by the Corporation of the City of Washington. Under these three laws, penal in form, a restaurateur's failure to serve or accommodate any well-behaved and respectable person, without regard to race or color, is a misdemeanor, punishable by fine and temporary forfeiture of license. The complaint was dismissed in the Municipal Court. The judgment of dismissal was affirmed in the Municipal Court of Appeals. *Held:* The legislation was the equivalent of local city ordinances which cannot support a civil suit for damages. *Tynes v. Gogos,* 144 A. 2d 412 (1958).

The court relied on a Supreme Court decision to support its classification of the legislation as ordinance and not as statute. See *District of Columbia v. John R. Thompson Co.,* [346 U.S. 100 (1954)] in which a defendant was charged in a criminal proceeding with a violation of the same legislation. It was argued for the defendant in the *Thompson* case that this old legislation had been repealed when Congress enacted the Code of laws for the District of Columbia in 1901. The Supreme Court held that the legislation of 1872 and 1873 was unaffected by the Code of 1901, for the Code did not repeal 'police regulations' adopted by the District legislature, and that the acts of 1872 and 1873 were valid expressions of the legislature's power under the Organic Act of 1871. The Organic Act, the Court said, gave the District legislature power "as broad as the police power of a state." 346 U.S. at p. 110.

It is submitted that the conclusion that the acts of 1872 and 1873 were 'ordinances, not statutes,' was never intended by the opinion in the *Thompson* case. It is one thing to say that legislation is 'police regulation,' and something else to say it is 'ordinance.' The promulgating source of legislation must be examined as well as the subject matter, in the process of classification. The court in the instant case conceded that plaintiff may recover in a civil action where defendant's conduct has breached state civil rights statutes, penal in form. See, e.g., *Powell v. Utz,* 87 F. Supp. 811 (E.D. Wash. 1949); *Anderson v. Pantages Theatre Co.,* 114 Wash. 24, 194 Pac. 813 (1921). There is no authority for the distinction between ordinances and statutes by the court. The Court quoted McQuillan's treatise, *The Law of Municipal Corporation,* as authority for this distinction. (Vol. 6, Sec. 22.01, 3d ed. 1949.) The quotation is excerpted out of context. There is no case law to support McQuillan. Cases cited involve such questions as the criminal capability of a cow [City of Goshen v. Crary, 58 Ind. 268 (1877)]; the violation of ordinance as contributory negligence [Shea v. Pillette, 108 Vt. 446, 189 Atl. 154 (1937)]; negligence of a mail carrier notwithstanding an ordinance giving free course to United States mails [Bain v. Ft. Smith Light & Traction Co.,

116 Ark. 125, 172 S.W. 843 (1915)]; violation of ordinance and presumption of negligence [Stark v. First Nat. Stores, 117 Vt. 231, 88 A.(2) 831 (1952)]. None of the cases involve civil rights ordinances. Obviously the great mass of case law on violation of an ordinance as negligence *per se* is immaterial: civil rights legislation creates an absolute obligation. See the state civil rights cases, *supra.*

Where violation of a municipal ordinance is the basis of a complaint in tort, care must be taken to avoid the possibility of entrapment of the violator by surprise abandonment of common law no-duty rules. Consideration must be given to the frequent inaccessibility of the ordinance to the citizen, in contrast to codified state statutes. Judicial reluctance to permit the tort action may be justified by the possibility of an award of substantial damages. See MORRIS, TORTS, p. 157-162. But in view of the well-known policy against discrimination in the District of Columbia, the business of the defendant which was subject (as he knew) to many affirmative legal duties, the wide-spread discussion and awareness of civil rights problems in the District and elsewhere, and the publication of these provisions of law in Supplement VI of the D. C. Code, it is suggested that such objections to tort liability are inapplicable.

JOSEPH P. JOSEPHSON

CONSTITUTIONAL LAW—SEARCHES AND SEIZURES—EVIDENCE SEIZED BY STATE OFFICERS WITHOUT A WARRANT INADMISSIBLE IN PROSECUTION IN FEDERAL DISTRICT COURT—State police officers responded to an early morning call from a motel keeper who had become suspicious of the conduct of certain of his guests. Without a warrant and under circumstances which constituted an unreasonable search and seizure, the officers gained admission to the quarters occupied by the defendant and a companion and seized a certain quantity of money found therein. The search and seizure was accomplished by state officers without any collaboration with federal agents. Defendant and the seized money were turned over to federal authorities in the District of Columbia where defendant was indicted for housebreaking and larceny. In the federal prosecution defendant sought to suppress as evidence the money discovered and seized by the state officers. The motion to suppress was overruled and conviction followed. On appeal defendant challenged the ruling of the trial court on the motion to suppress. *Held:* Evidence obtained by state officers as a result of an illegal search is inadmissible in a federal prosecution even though the search was made without involvement of federal officers. *Hanna* v. *United States,* U.S. App. D.C. No. 14, 462 decided Oct. 2, 1958.

The Federal Constitution (U.S. CONST., amend. IV) and the constitution of each of the states (e.g. N.Y. CONST., art. I, § 12; CALIF. CONST., art. I, § 19) contain a prohibition against unreasonable searches and seizures. Although the mandate is clear, free-wheeling law enforcement techniques, ignoring the constitutional prohibitions, focus judicial attention on remedial devices for victims of unlawful searches and seizures. The celebrated case of *Weeks* v. *United States,* 232 U.S. 383 (1914), established the doctrine that evidence illegally obtained by federal officers is inadmissible in a federal prosecution. Professor Wigmore criticizes the holding as one based on "misguided sentimentality." 8 WIGMORE, EVIDENCE 36 (3d ed. 1940). The majority of state courts, refusing to let the criminal

"go free because the constable has blundered" [People v. Defore, 242 N.Y. 13, 21, 150 N.E. 585, 587 (1926)] reject the exclusionary rule. See the cases collected in Appendix to *Wolf* v. *Colorado* 338 U.S. 25, 33-39 (1949) and Annotation 50 A.L.R. 2d 531, 535. The remedy afforded a victim of an unlawful search and seizure in these states is a trespass action against the offending officer and in certain instances an opportunity to secure the return of the property unlawfully seized. Grant, *Circumventing the Fourth Amendment,* 14 So. CALIF. L. REV. 359 (1941). A substantial minority of state courts have adopted the rule of exclusion. See the cases collected in Appendix to *Wolf* v. *Colorado, supra,* at 33-39 (1949) and Annotation 50 A.L.R. 2d 531, 536. The most recent convert to the federal view is the state of California. *People* v. *Cahan,* 44 Cal. 2d 434, 282 P. 2d 905, 50 A.L.R. 2d 513 (1955).

The *Weeks* decision had another prong. The Supreme Court reasoned that since the Fourth Amendment reached only the federal government and its agencies, evidence seized by state officers acting without claim of federal authority was not barred by the exclusionary rule, regardless of the method of procurement. The holding was reiterated [Byars v. United States, 273 U.S. 28 (1927)] and followed throughout the federal system without deviation until the instant case. By way of comparison, the majority of states which exclude the fruits of the wrongdoing of their own officers have refused to become outlets for evidence obtained by federal officers under similar circumstances. See cases collected in Annotation 50 A.L.R. 2d 531, 575. Quite naturally, states which have not adopted the rule admit evidence obtained by unlawful search and seizure from whatever source. E. g. *Terrano* v. *State,* 59 Nev. 247, 91 P. 2d 67 (1939).

The double aspect of the decision in *Weeks* led to refinements in the application of the rule of exclusion in federal courts. Since admissibility turned on whether errant police officers were of federal or state vintage and since as a practical consideration the spheres of state and federal law enforcement agencies are not entirely independent of each other, the involvement, in varying degrees, of federal officers in unreasonable searches and seizures conducted by state officers presented additional questions to the courts. In *Byars* v. *United States, supra,* the Supreme Court held that active "participation" by the federal government itself or through its agents in an illegal state search and seizure rendered the product thereof inadmissible in federal courts. The Supreme Court has reiterated the doctrine of "participation" as follows: "The crux of that doctrine is that a search is a search by a federal official if he had a hand in it; it is not a search by a federal official if evidence secured by state authorities is turned over to federal authorities on a silver platter." *Lustig* v. *United States,* 338 U.S. 74 (1949). See Note 38 GEO. L. J. 148 (1949). The exclusionary rule was given broader application in *Gambino v. United States.* 275 U.S. 310 (1927). There New York state police, who otherwise were under no duty to enforce the federal prohibition laws, were instructed by the governor and the Federal Prohibition Director, on repeal of the state prohibition act, to aid in the enforcement of the federal act. Evidence seized as a result of a search without warrant or probable cause by state police acting solely on behalf of the United States for the purpose of enforcing federal law, was held inadmissible in a federal prosecution. Although federal officers had not "participated" in the illegal search, its fruits were rendered inadmissible because

of the "co-operation" of state officers acting solely to enforce laws of the United States. The "co-operation" doctrine has evoked some confusion in the lower courts. Disagreement as to the elements of "co-operation" and thus to the applicability of the rule of exclusion in some measure stem from the fact that in *Gambino* state officers were acting solely in aid of the enforcement of the laws of the United States. Where there is general co-operation between state and federal officers and where federal officers in fact adopt the prosecution which state officers have begun as a result of their search, the fact that the state officer is not acting solely in behalf of the United States has been held immaterial and the evidence inadmissible in a federal prosecution. *Sutherland* v. *United States,* 92 F. 2d 305 (4th Cir. 1937). *Cf. Fowler* v. *United States,* 62 F. 2d 656 (7th Cir. 1932); *Lowrey* v. *United States,* 128 F. 2d 477 (8th Cir. 1942). Under similar circumstances evidence has been admitted for the reason that the state officers "were not acting *solely* for the *purpose of aiding in the enforcement of federal law." United States* v. *Scotti,* 102 F. Supp. 747 (E.D. Tex. 1950) aff'd 193 F. 2d 644 (5th Cir. 1952). The courts are uniform in holding that the fruits of an illegal state search conducted on the instigation of federal authorities cannot be used in a federal prosecution. *United States* v. *DeBousi,* 32 F. 2d 902 (D. Mass. 1929); *Crank* v. *United States,* 61 F. 2d 981 (C.A. 8th, 1932). The questions involved above become moot if the instant case accurately states the law today.

The cornerstone of the instant case is *Wolf* v. *Colorado, supra.* There the Supreme Court canonized the right to be secure against unlawful searches and seizures, guaranteed by the Fourth Amendment, as "basic to a free society" and enforceable against the states through the due process clause of the Fourteenth Amendment. The precise holding was that although an unlawful search and seizure by state officers is a violation of the Fourteenth Amendment, due process does not require the state courts to exclude evidence so obtained. In the principal case the court reasons that the inclusion of the guarantee of the Fourth Amendment within the concept of "flexible due process" overrules the constitutional basis on which *Weeks* had authorized federal use of state procured illegal evidence.

Significantly, the several Courts of Appeals subsequent to the decision in *Wolf* have continued to sanction the practice which the principal case condemns. E.g. *Jones* v. *United States,* 217 F. 2d 381 (8th Cir. 1954); *United States* v. *Haywood,* 208 F. 2d 156 (7th Cir. 1953); *Serio* v. *United States,* 203 F. 2d 576 (5th Cir. 1953) cert. den. 346 U.S. 887; *Watson* v. *United States,* 224 F. 2d 910 (5th Cir. 1955); *Gallegos* v. *United States,* 237 F. 2d 694 (10th Cir. 1956); *United States* v. *Moses,* 234 F. 2d 124 (7th Cir. 1956). The holding under consideration is not, however, a shot in the dark. The court points to expressions by individual members of the Supreme Court which indicate that the second prong of *Weeks* might no longer control. E.g. Mr. Justice Frankfurter in *Lustig* v. *United States, supra* at 79, (1949) and Chief Justice Warren in *Benanti* v. *United States,* 353 U.S. 96, 102, n. 10 (1951).

Whether the rule of exclusion results from an implied command of the Constitution or is merely a judicially created rule of evidence is not clear. Note, 50 COL. L. REV. 364 (1950); Comment, 64 HARV. L. REV. 1304 (1951). Speculation as to what the future holds for the decision under consideration must be made with an eye to the policy considerations which conflict with the federal interest in

protecting the newly announced federal right to be secure from unreasonable state searches and seizures. That concern competes with the avowed distaste of the federal courts for encroachments upon the sphere of state law enforcement agencies and with the federal interest in the vigorous enforcement of federal criminal law. See Parsons, *State-Federal Crossfire In Search and Seizure and Self-Incrimination*, 42 CORN. L. Q. 346, 362 (1957) (suggesting as a means of balancing conflicting interests that federal courts refuse to accept evidence illegally obtained by officers of states which have adopted the rule of exclusion). With respect to the former, the exclusionary rule as extended by the instant case operates to regulate the conduct of state law enforcement agencies. See and compare *Stefanelli* v. *Minard*, 342 U.S. 117 (1951) with *Rea* v. *United States*, 350 U.S. 214 (1956). Is the degree of interference great? Two factors might justify a negative response. (1) Where violations of *state* criminal laws are involved (regardless of whether the conduct also constitutes a violation of federal law) *state* policy will continue to determine whether tainted evidence is admissible in *state* courts. (2) Where the federal law *alone* is being enforced by state officers there is precedent for excluding illegally obtained evidence.

With respect to the second competing concern, the interest of the public in the vigorous enforcement of federal criminal law, it would seem that the federal courts stand committed. By resort to some judicial gerrymander it might be perceived that while the prohibition against illegal searches and seizures guaranteed by the Fourth Amendment has vitality only through the rule of exclusion, the same guarantee embodied in the Fourteenth can thrive without it. But the considerations which in federal prosecutions involving federal illegal searches and seizures subordinate the public interest in stern law enforcement to the protection of the constitutional right are as persuasive when a federal prosecutor seeks to make use of state procured illegal evidence.

In resolving the policy conflicts the notion of "judicial integrity," keynoting the opinion in the instant case, is significant. That "the nation may keep what servants of the States supply" [People v. Defore, supra at 22, 150 N.E. at 588 (1926)] has long been a whipping post for states rejecting the rule of exclusion. The objection is, however, even more weighty when made by states which have adopted the rule and whose offices may still benefit from their wrongdoing by turning over the illegally obtained evidence to federal authorities. To deplore the unlawful conduct and yet make use of its progeny undoubtedly smacks of duplicity. Perhaps the elimination of that duplicity alone is sufficient basis for the broader application of the rule of exclusion.

DON P. MURNANE